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MCI WORLD COM

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May 4, 2000

EX PARTE

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

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OFFICE OF THE SECRETARY

CC Docket No. 99-333

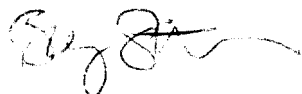
Dear Ms. Salas:

Yesterday, Stan Besen, Steve Brenner and Chris Cavanagh of Charles River Associates, Inc., Michael Pelcovits and I of MCI WorldCom, Richard Metzger of Lawler, Metzger and Milkman along with Craig Dingwall of Sprint and Sue Blumenfeld and Renee Callahan of Wilkie, Farr and Gallagher met with Claudia Fox, Mark Uretsky, Daniel Shiman, Eric Einhorn, Henry Thaggert, Pamela Megna, Lisa Choi, Bill Rogerson, Christopher Libertelli, Jim Bird and Donald Stockdale, regarding the above referenced matter.

In the meeting we discussed the declarations in both the Application of Transfer filed November 17, 1999 and Reply filing of March 20, 2000 regarding state of competition in the long distance market and the likely impact of the MCI WorldCom-Sprint combination. The attached presentation was used during this meeting.

In accordance with section 1.1206(b)(2) of the Commission's rules, 47 C.F.R. § 1.1206(b)(2), an original and one copy of this memorandum are being filed with your office.

Sincerely,



Bradley Stillman

cc: Claudia Fox
Mark Uretsky
Daniel Shiman
Eric Einhorn
Henry Thaggert
Pamela Megna
Pamela Megna
Lisa Choi
Bill Rogerson
Christopher Libertelli
Jim Bird
Donald Stockdale

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Competition in Domestic Long Distance Service

Stanley M. Besen and Steven R. Brenner
Charles River Associates Incorporated
May 3, 2000

A Changing Marketplace: The Role of Emerging Carriers

- Building new networks
- Building mass market presence
 - Taking advantage of a marketplace with high churn rates and limited consumer loyalty
 - Growing share without substantial national advertising
- Building capabilities and winning contracts for both traditional and new business services

A Continually Evolving Marketplace

- Shares of sales have been steadily shifting
 - Emerging carriers have grown share
 - AT&T has lost share while MCI WorldCom's and Sprint's shares have been relatively stable
- Accelerating change as emerging carriers have built new networks
- Competitive analysis should take into account this changing marketplace
 - Current measures of shares and concentration are inadequate for gauging the competitive impact of the merger

Issues: Long Distance Competition

- The growing share of capacity controlled by emerging carriers
- Mass Market
 - (Un)Importance of customer loyalty and brand
 - Critique of statistical demand estimates and simulations
- Increasing success of emerging carriers in selling to larger businesses

Emerging Carrier Networks: Facts

- Networks in place:
 - Qwest: 18,000 route miles connecting 150 cities.
 - Williams: 32,000 route miles planned by the end of 2000.
 - IXC/Broadwing: 15,000 route miles by the end of 1999.
 - Frontier: 12,000 route miles by the end of 1998, 20,000 route miles connecting 120 cities planned by completion.
 - Level 3: 16,000 route miles expected to be 94 percent complete by the end of 2000.
 - Teleglobe, Enron, C&W...
- More to come...

Emerging Carrier Networks: Competitive Significance

- Emerging carriers control a substantial share of long distance capacity and will control an even larger share in the near future
- Control of fiber -- by long term lease or IRU -- is economically significant even if the carrier did not itself construct the network

Emerging Carrier Networks: Competitive Significance (continued)

- One input, but a significant one
 - Constructing a fiber network is time consuming and requires a substantial “lumpy” commitment of capital
 - Other inputs can be added incrementally — capacity is scalable
 - Lighting fiber to create usable bandwidth
 - Adding packet-switches, circuit switches, routers....
 - Capacity increments can be added relatively quickly

Emerging Carrier Networks: Competitive Significance (continued)

- Fiber networks enable supply expansion
 - Of either circuit or packet-switched services (including those based on IP)
 - Rapid entry possible because carriers can acquire control of already-constructed fiber; e.g.:
 - Teleglobe acquiring capacity from Williams
 - Cable & Wireless from Level 3
- Bottom line: bandwidth will not be a constraint on supply expansion by emerging carriers

Mass Market Issues

- Background: A pattern of success for emerging carriers
- Underlying market conditions: churn
- Evidence on the (in)significance of brand
- Critique of statistical results

A Pattern of Success for Emerging Carriers

- In the aggregate:
 - Share of residential access lines served by emerging carriers grew by over 8 percentage points from 1995 to 1998 (8.3% to 16.6%).
 - Share of residential direct dial toll minutes grew by over 9 percentage points from 1995 to 1998 (8.6% to 18.0%).
 - Share of residential toll revenue grew by over 6 percentage points from 1995 to 1998 (11.3% to 17.6%).
 - Combined share substantially exceeds that of Sprint and is about the same as that of MCI WorldCom

A Pattern of Success for Emerging Carriers (continued)

- Individual carriers have shown ability to grow rapidly
 - Excel Telecommunications: Access lines served grew from about 220 thousand to almost 3.8 million between June 1995 and December 1996.
 - Talk.com: Sold over 1.5 million access lines between launch in 1997 and January 1999.

A Fact of Competitive Life: Customer (Dis)Loyalty

- A large proportion of MCI WorldCom's and Sprint's customer bases turn over in a 12 to 18 month period
- Percent of customers that switch main vendor within 12 months:
 - MCI WorldCom: 44 percent (49 percent within 18 months).
 - Sprint: 49 percent (60 percent within 18 months).
 - AT&T: 37 percent (49 percent within 18 months)
- Must actively win customers or lose share rapidly

Many Households Use “Unbranded” Service

- For direct-dialed interLATA calls:
 - 43 percent of households used *an emerging carrier* at least once within 12 months.
 - 48 percent of households used *a service without an AT&T, MCIW, or Sprint brand name* at least once within 12 months.
- As main vendor:
 - 36 percent of households used *an emerging carrier* for at least one month within 12 months.
 - 40 percent of households used a service *without an AT&T, MCIW, or Sprint brand name* for at least one month within 12 months.

Many Customers Switch to Emerging Carriers

- 36 percent of *MCI WorldCom* dial 1 customers that changed main vendor switched to an emerging carrier (42 percent to an “unbranded” service).
- 31 percent of *Sprint* dial 1 customers that changed main vendor switched to an emerging carrier (39 percent to an “unbranded” service).
- 46 percent of *AT&T* dial 1 customers that changed main vendor switched to an emerging carrier (60 percent to an “unbranded” service).

Ratio of Actual to Predicted Number of Customers Switching Main Vendor

- MCI WorldCom dial 1 to emerging carrier: 1.44
- MCI WorldCom dial 1 to Sprint: 0.90
- Sprint to emerging carrier: 1.45
- Sprint to MCI WorldCom dial 1: 1.00

Critique of Hausman's Unilateral Effects Analysis

- Econometric demand results should not be relied upon because of problems of modeling, use of data, statistics, and interpretation
- Estimated merger price effects are driven by the econometric demand estimates and also should not be relied upon

Critique of Hausman's Unilateral Effects Analysis (continued)

- Modeling problems
 - Analysis fails to take into account that customers do not respond fully to price offers within one month
 - Result: understate longer term responsiveness to price
- Data problems
 - Apparent failure to account fully for special promotions, which induce many switches
 - Average price paid by a carrier's customers may not accurately measure prices paid by customers that switch to that carrier
 - Apparent failure to account for fixed charges

Critique of Hausman's Unilateral Effects Analysis (continued)

- Statistical problems
 - No information about standard errors or confidence intervals
 - Are results robust?
- Problems of interpretation
 - Implied margins appear inconsistent with known carrier costs (for AT&T imply marginal cost is 10.7% of price).
 - Implied margins and marginal costs appear to vary unreasonably across carriers (implied marginal cost ranges from about 1.8 to 6.5 cents per minute).

Emerging Carriers Well Positioned to Serve Larger Businesses

- “New generation” networks have data-centric designs, suiting them to satisfy rapidly growing demand for data transport
- Integrated transport of data and voice traffic
- New networks have ample capacity to meet demand for high bandwidth

Business Service: Announced Successes by Emerging Carriers

- Many contracts from *large business customers* won by emerging carriers.
 - e.g., Ford Motors, Intel, Delta Air Lines, Nortel, Fox, Turner Broadcasting, Walgreen, WinStar, Electric Lightwave, Verio.
 - Qwest reports contracts with 40 of the Fortune 50.

Announced Successes by Emerging Carriers (continued)

- Emerging carriers have won large business contracts for a *wide range of services*.
 - e.g., traditional data, frame relay, ATM, traditional voice, VPN, teleconferencing, toll-free, Internet access.
- Many instances of *partnering* between emerging carriers and other suppliers.
 - Qwest/Bell South a prominent example

Emerging Carriers Are Increasingly Important Suppliers to Larger Business Customers

- Growing capacities and capabilities of emerging carriers to serve larger businesses
- Emerging carriers appear to be increasingly important competitors for new larger business contracts
- Current shares of sales to larger business customers understate current and future competitive significance of emerging carriers

Conclusions

- Must look at more than current shares: the continuing evolution of the marketplace must be taken into account in a competitive analysis:
- Control of fiber networks by emerging carriers facilitates supply expansion
- Mass market exhibits high churn, relatively low brand loyalty
- Emerging carriers are building capabilities and winning large business contracts